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THE INVESTMENT ADVISERS ACT OF 1940: IS A GENERAL PARTNER OF A LIMITED PARTNERSHIP AN INVESTMENT ADVISER?

Various expressions of policy by the Securities and Exchange Commission as well as a recent decision by the Second Circuit have created uncertainty with respect to the applicability of the Investment Advisers Act of 1940 to general partners of limited partnerships. While the Commission urges that the Advisers Act was designed to cover the securities advisory activities of business firm managers not reached by the Investment Company Act of 1940, the author, after examining the policies underlying these companion acts, constructs an analytical framework for the application of the definition of an investment adviser. Focusing on the nature of the limited partnership's asset project, the general partner's management function, and the method for compensating the general partner, the author proposes that the general partner be deemed an investment adviser only when he offers securities advice in a capacity removed from day-to-day management activities of his firm.

INTRODUCTION

DESPITE THE SIGNAL decision of the Second Circuit in *Abrahamson v. Fleschner*¹ and numerous no-action letters² issued by the

1. 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978). In *Abrahamson*, the court found that an implied private right of action existed under § 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1976). The case arose when two limited partners sued the partnership, its accountants, and its general partners for failure to disclose substantial investment of partnership assets in unregistered securities. 392 F. Supp. 740, 741 (S.D.N.Y. 1975). The plaintiffs contended, *inter alia*, that the failure to disclose constituted fraudulent conduct under § 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1976). *Id.* The defendants responded that they were not investment advisers within the meaning of § 202(a)(11) of the Act and that the plaintiffs had realized no losses compensable under the Act. *Id.* at 743-44. The district court granted the defendants' motion for summary judgment, stating that the complaint had failed to allege compensable damages. *Id.* at 750.

On appeal, the Second Circuit saw the inquiry presented by the Advisers Act claim as threefold: First, were any of the general partners investment advisers under § 202(a)(11); second, was there an implied private right of action under § 206; and third, had the plaintiffs alleged compensable damages. 568 F.2d at 869.

The court of appeals held that the general partners were investment advisers since they were "engage[d] in the business of advising others' with respect to investments" and were compensated for this advice. *Id.* at 870. The second issue—whether there was an implied private right of action under § 206—was one of first impression. The court concluded that in order to effectuate the broad remedial purposes of the Act it was necessary to recognize a private right of action so that the Act's enforcement would not be left entirely to the Securities and Exchange Commission. *Id.* at 872. Finally, the court held that the plaintiffs' claim for damages was not too speculative. *Id.* at 878. For further references on this implied private right of action, see note 17 *infra*.

2. An individual may receive informal advice from the staff of the SEC concerning

staff of the Securities and Exchange Commission,³ uncertainty persists within the investment community concerning the status of general partners of limited partnerships as investment advisers, as defined in the Investment Advisers Act of 1940 (the Advisers Act).⁴ This uncertainty is particularly troublesome in light of the frequent use of the limited partnership as an investment vehicle.⁵ The uncertainty relates to two issues: (1) whether a general partner is an investment adviser under section 202(a)(11) of the Advisers Act;⁶ and (2) if so, under what circumstances will he be required to register?⁷

the interpretation of securities laws by submitting a written request to which the staff will give a written reply indicating whether it would or would not recommend that the Commission take enforcement action if the conduct described in the request occurs. The position taken by the staff in these replies is subject to reconsideration and may not be regarded as binding upon the SEC. SEC Securities Act Release No. 5037 (July 14, 1970), *reprinted in* [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,838.

The term "no-action request" will be used in this Note to refer to a letter submitted to the staff of the SEC seeking interpretation of securities laws. The term "no-action letter" will be used to refer to the staff's response. No-action letters referred to in this Note are cited to the *Federal Securities Law Reporter* (CCH), if available. Unpublished correspondence will be cited by the name of the requesting party and the date on which the staff's response was made public. These latter letters may be obtained from the SEC or by using LEXIS.

3. *E.g.*, John Terwilliger, SEC no-action letter (June 27, 1977); Michael Coleman & Lawrence Grenon, SEC no-action letter (July 28, 1976); The Consartium Fund, SEC no-action letter (Sept. 3, 1975); Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975).

4. Section 202(a)(11) of the Act, 15 U.S.C. § 80b-2(a)(11) (1976), defines investment adviser as follows:

"Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank . . . ; (B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) any person whose advice, analyses or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States . . . ; or (F) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.

5. See notes 23-24 *infra* and accompanying text.

6. 15 U.S.C. § 80b-2(a)(11) (1976).

7. A person who qualifies as an investment adviser under § 202(a)(11) is required to register with the SEC pursuant to § 203, *id.* § 80b-3, unless exempted by one of the provisions of § 203(b). Section 203(b) reads as follows:

The provisions of subsection (a) of this section shall not apply to—

(1) any investment adviser all of whose clients are residents of the State

Classification of the general partner as an investment adviser subject to registration gives rise to a number of potentially significant problems. One immediate problem is the basic conflict between compensation restrictions placed on *registered* advisers and the normal modes of compensating general partners of limited partnerships. Section 205(1) of the Advisers Act prohibits a registered investment adviser from basing his compensation on a percentage of the capital gains upon, or capital appreciation of, a client's funds.⁸ Because profit-sharing is a fundamental aspect of many general partners' compensation,⁹ this restriction would upset traditional practices and expectations and eliminate one of the underlying incentives to form limited partnerships.¹⁰

The registration and reporting requirements¹¹ of the Advisers Act present a less significant, but nonetheless time-consuming and burdensome problem for the general partner required to register. Certain regulations promulgated by the SEC could be construed to require the general partner to maintain all the designated books and records for each individual limited partner on an ongoing basis.¹²

within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges or any national securities exchange;

(2) any investment adviser whose only clients are insurance companies; or

(3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under subchapter I of this chapter.

For a discussion of the registration requirements and exemptions therefrom, see Lovitch, *The Investment Advisers Act of 1940—Who Is an "Investment Adviser"?*, 24 KAN. L. REV. 67, 69-72 (1975).

8. 15 U.S.C. § 80b-5(1) (1976). The profit-sharing restrictions apply only to registered investment advisers and do not apply to persons who qualify under the definition of "adviser" in § 202(a)(11) but are exempted from registration by § 203(b).

9. See Hacker & Rotunda, *Sponsors of Real Estate Partnerships as Brokers and Investment Advisers*, 23 U.C.L.A. L. REV. 322, 325 & n.13 (1975). See also REVISED UNIFORM LIMITED PARTNERSHIP ACT § 503.

10. The SEC staff has already indicated that the § 205(1) restrictions will apply to profit-sharing compensation arrangements of general partners who are deemed investment advisers. Capital Investment Group, Inc., SEC no-action letter (July 9, 1972); Computer Directions Advisors, Inc., SEC no-action letter (June 4, 1972); Gardner and Preston Moss, Inc., SEC no-action letter (Feb. 23, 1972), *reprinted in* [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,638.

11. Advisers Act §§ 203, 204, 15 U.S.C. §§ 80b-3, -4 (1976); 17 C.F.R. § 275.203-1, -2, -3, -204-1, -2 (1978).

12. See 17 C.F.R. § 275.204-2(b), -2(c) (1979) (adviser supervising, managing, or having custody of securities portfolio required to keep certain records for each client).

A general partner of a venture capital limited partnership recently received an exemption from the profit-sharing provisions of § 205(1) and, in part, from the record keeping

Classification as an investment adviser is significant to the general partner even if he qualifies for an exemption from registration.¹³ General antideception liability provisions, as well as prohibitions on specific activities, contained in section 206 of the Advisers Act and rules promulgated thereunder apply to any person deemed an adviser, regardless of whether he is exempt from registration.¹⁴ Any person engaged in practices that violate these rules is subject to injunctive action by the SEC¹⁵ and possibly to federal criminal penalties.¹⁶

One additional consequence of including general partners within the definition of investment advisers is the possibility of their being held subject to a private cause of action for fraud under section 206 of the Advisers Act.¹⁷ In an enforcement action by the Commission in *SEC v. Capital Gains Research Bureau*,

requirements of rule 204-2(b) and (c). In the Matter of Foster Management Company, SEC Investment Advisers Act Release No. 651 (Nov. 28, 1978).

The Commission has proposed that certain registered advisers to business development companies (venture capital firms) be permitted to be compensated on the basis of a share of net capital gains on the funds of the business development company. Performance-Based Compensation of Registered Investment Advisers to Business Development Companies; Proposed Rule, SEC Investment Advisers Act Release No. 680 (June 19, 1979), *reprinted in* [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,113.

13. See note 7 *supra*.

14. 15 U.S.C. § 80b-6 (1976) provides:

It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction of the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

15. Advisers Act § 209(e), 15 U.S.C. 80b-9(e) (1976).

16. *Id.* § 217, 15 U.S.C. § 80b-17 (1976) (providing for criminal liability for willful violations of the Advisers Act).

17. See note 1 *supra*. Courts have divided on the issue of an implied private right of action under the Advisers Act. Compare *Abrahamson v. Fleschner*, 568 F.2d 862, 872-76 (2d Cir. 1977) (finding implied right of action), *cert. denied*, 436 U.S. 913 (1978) with *Greenspan v. Del Toro*, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,488 (S.D. Fla. 1974) and *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] FED.

Inc.,¹⁸ the Supreme Court stated, in its only express interpretation of any provision of the Advisers Act, that section 206 "is to be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purpose."¹⁹ Thus, the general partner classified as an investment adviser may be exposed to the broad and remedial construction of the general antideception liability provisions found in section 206.²⁰

In sum, characterization of a general partner as an investment adviser may expose him to more liability and place more limitations upon his activities and remuneration than he has traditionally bargained for. These disincentives may ultimately have an adverse effect upon the attractiveness and viability of limited partnerships as investment vehicles.

After a brief description of the common characteristics of limited partnerships, this Note will attempt to extract the essential legislative policies underlying the Advisers Act and its companion enactment, The Investment Company Act of 1940.²¹ These policies will be used as a framework for analyzing the statutory definition of an investment adviser. This analysis will then be applied to the limited partnership investment context to determine whether a general partner may be appropriately characterized as an investment adviser. Concluding that the general partner may not be an investment adviser under many limited partnership arrangements that are popularly employed today, the Note proposes an analytical approach to determine those situations in which the

SEC. L. REP. (CCH) ¶ 94,761 (S.D. Cal. 1974) (both cases finding no implied right of action).

This issue is currently before the Supreme Court in *Lewis v. Transamerica Corp.*, 575 F.2d 237 (9th Cir. 1978), *cert. granted sub nom.* *Transamerica Mortgage Advisors, Inc. v. Lewis*, 439 U.S. 952 (1978).

For a full discussion of *Abrahamson* with particular attention to the private cause of action issue, see Recent Case, 30 VAND. L. REV. 905 (1977). See also Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 MICH. L. REV. 308 (1975), noted in *Abrahamson v. Fleschner*, 568 F.2d at 872 n.17.

18. 375 U.S. 180 (1963).

19. *Id.* at 195.

20. The Supreme Court in *Capital Gains* distinguished the § 206 antideception provisions from a common law action in fraud by concluding that the Advisers Act empowered "the courts to enjoin any practice which operates 'as a fraud or deceit' upon a client, [and that Congress] *did not intend to require proof of intent to injure and actual injury to the client.*" *Id.* (emphasis added).

21. 15 U.S.C. §§ 80a-1 to -52 (1976).

general partner's activities may be within the purview of the Advisers Act.

I. THE POLICIES OF THE ADVISERS ACT WITHIN THE CONTEXT OF THE LIMITED PARTNERSHIP

A. *General Description of Limited Partnerships*

The analysis in this Note concludes that the proper application of the Advisers Act definition of the investment adviser turns upon three principal characteristics of limited partnerships: (1) the underlying asset project of the limited partnership, that is, the use to which investors' contributed capital is put; (2) the nature of the management function of the general partner; and (3) the nature of the compensation arrangement between the general partner and the limited partnership. These characteristics vary significantly among limited partnerships. This section will briefly describe some of the possibilities.²²

1. *Nature of the Underlying Asset Project*

Limited partnerships exist for countless business objectives.²³ During the last decade, limited partnerships have become increasingly popular as a business form, primarily because of their potential tax benefits.²⁴ Of particular relevance in determining the coverage of the Advisers Act is whether the partnership's underlying asset project involves securities.²⁵ While some partnerships,

22. For a more comprehensive account of the varying forms of limited partnership organization, see Hacker & Rotunda, *supra* note 9, at 324-326.

23. The many purposes for which limited partnerships have been formed include managing venture capital investments, e.g., Bankamerica Investment Management Corp., SEC no-action letter (April 27, 1978), reprinted in [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,697; providing financial support to new businesses, e.g., Fidelity Venture Assoc., SEC no-action letter (Dec. 21, 1977); investing in works of art, e.g., The Consartium Fund, SEC no-action letter (Sept. 3, 1975); and effecting a corporate takeover, e.g., Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975).

24. See, e.g., Sperling & Lokkan, *The Limited Partnership Tax Shelter: An Investment Vehicle Under Attack*, 29 U. FLA. L. REV. 1 (1976); Van Camp, *Living With Tax Shelters in California: A Discussion of the New California Real Estate Syndication Rules*, 7 U.S.F. L. REV. 403 (1973).

The advantage of the limited partnership form is that it allows start-up costs, depreciation deductions, and other business losses to flow directly through to the limited partners, who are thereby provided with tax items that shelter general accounting profits flowing from the partnership as well as income received by the partners from other sources. In addition to saving tax dollars, an investor in a limited partnership may of course benefit from any general accounting profits earned by the partnership enterprise. See I.R.C. § 702.

25. See notes 89-106 *infra* and accompanying text.

such as hedge funds,²⁶ are almost exclusively involved with the buying and selling of securities, others' involvement with securities is not so apparent and depends upon a difficult factual and legal determination of the nature of the portfolio.²⁷

2. *Nature of the General Partner's Management Function*

The general partner is often the "sponsor" of a limited partnership.²⁸ He will structure the partnership by preparing the necessary agreements and documents, and then sell the limited partnership interests to prospective limited partners.²⁹ Once the partnership is established, the general partner's function will vary, depending on the nature of the partnership's underlying asset project and the number of limited partnerships served by the general partner. The general partner may assume a purely managerial function, handling alone or with other general partners all the business affairs of the partnership, and thereby devoting full-time, particularized attention to the partnership. Alternatively, the general partner may have minimal, stereotyped managerial duties in which he does not give particularized attention to any one partnership. Instead, he may devote his time to the organization of other partnerships, often with many of the same limited partners, many of whom may invest in several partnerships simultaneously or seriatim.³⁰

3. *Nature of the General Partner's Compensation*

Various methods may be used to compensate the general partners. The type of compensation will depend in large part on the nature of the limited partnership and the function the general partner fulfills. Both special fees for specific services and equity

26. A hedge fund is defined as "a limited partnership in which the contributions of a small number of limited partners are pooled and invested and reinvested by the general partner in a portfolio of securities." Hacker & Rotunda, *supra* note 9, at 336.

27. See Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367 (1967). For example, in the real estate context, partnership investment in a second partnership holding real estate has been deemed to be investment in a security. See Hacker & Rotunda, *supra* note 9, at 323 n.7.

28. Hacker and Rotunda observe that in the real estate tax shelter industry, corporate general partner-"sponsors" are the norm. Hacker & Rotunda, *supra* note 9, at 324.

29. *Id.* Such offerings are usually made so as to comply with the private placement exemption from registration set out in § 4(2) of the Securities Act of 1933, 15 U.S.C. § 77d(2) (1976), and rule 146, 17 C.F.R. § 230.146 (1979), promulgated thereunder. *Id.* at 325-26. See also Halloran, *Partnerships: Securities Law Aspects*, in ALI-ABA RESOURCE MATERIALS: PARTNERSHIPS 387, 395-401 (1977).

30. See generally Hacker & Rotunda, *supra* note 9, at 324-26.

shares greater than proportionate capital contributions have been used.³¹ Alternatively, the general partner may be paid a fixed salary solely for his services as a full-time manager of partnership affairs or specifically for advice about investments.

B. *Historical Background of the Advisers Act*

An examination of the history of the Advisers Act reveals that it was designed primarily to provide a simple form of occupational licensing for the emerging profession of independent counselors. Moreover, it is evident that Congress envisaged a furnisher of advisory services who had a pecuniary interest in the securities performance of the advisee-firm's portfolio, where that performance was a function of the investment advice he provided, but did not have an interest in the advisee-firm as an investor or a full-time, salaried employee-manager. The measures adopted to eliminate potential conflicts of interest between adviser and client, not adequately addressed by local business association law regulating manager-firm relations, reflect this perspective of the adviser as one who stands in a posture external³² to the investor.

Section 30 of the Public Utility Holding Company Act of 1935³³ directed the SEC to conduct a study of investment trusts and investment companies. As a supplement to its comprehensive study of investment trusts and investment companies,³⁴ the SEC conducted a more cursory survey³⁵ of the activities of "those investment counselors who are associated with investment companies."³⁶ Two separate problem areas emerged from this latter

31. *Id.*

32. The concept of "externality" is critical to the analysis in this Note and is developed in notes 72-86 *infra* and accompanying text. In the context of this Note, the term implies characteristics which are in contradistinction to the qualities of a purely internal business manager, whose position involves irrevocable discretionary management prerogatives invested by business association law and who receives for his full-time services compensation that is undifferentiated as to his function, among other functions, as furnisher of advice about his firm's securities.

33. 15 U.S.C. § 79z-4 (1976).

34. The SEC's report of the study was published in four parts during the years 1938-1941. SEC, REPORT ON THE STUDY OF INVESTMENT TRUSTS AND INVESTMENT COMPANIES, H.R. DOC. NO. 707, 75th Cong., 3d Sess. (1938); H.R. DOC. NO. 70, 76th Cong., 1st Sess. (1939); H.R. DOC. NO. 279, 76th Cong., 1st Sess. (1939-40); H.R. DOC. NO. 136, 77th Cong., 1st Sess. (1941); H.R. DOC. NO. 246, 77th Cong., 1st Sess. (1941).

35. H.R. DOC. NO. 477, 76th Cong., 2d Sess. (1939).

36. *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 51 (1940) (statement of David Schenker, Chief Counsel, SEC Investment Trust Study) [hereinafter cited as *Senate Hearings*].

survey, both of which were ultimately reflected in the Advisers Act. The first area of concern, and the one receiving primary attention during the congressional hearings on the Advisers Act, was how to distinguish between bona fide investment counselors and the "tipsters and touts" making up the investment counsel fringe.³⁷ To this end the SEC recommended, as the fundamental objective of the Advisers Act, a compulsory census of all investment advisers.³⁸

The second problem area involved the organization and operation of investment counsel institutions. Of major concern were the potential abuses that could arise in the course of advising the investor client.³⁹ In view of the specific abuses envisaged by the SEC and considering the type of investment adviser which it stud-

By admission of the chief counsel to the SEC Investment Trust Study, the study of investment advisers was limited in scope, focusing on the single category of adviser associated with investment companies. *Id.* Because the supplemental report on investment advisers was an outgrowth of the Investment Trusts and Investment Companies Study, the SEC believed its jurisdiction with respect to the scope of the investigation was limited to gathering detailed information only from "people who acted as [external] investment managers to investment companies" *Id.* at 49. As a result, only 70 of the 5,335 pages of reports submitted to Congress by the SEC in connection with the Investment Trusts and Investment Companies Study were concerned with investment advisers and only 72 of the 1,276 pages of congressional hearings were related to the Advisers Act. *Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 307 (1940)* (report of Robert E. Healy, SEC Commissioner).

37. H.R. REP. NO. 2639, 76th Cong., 3d Sess. 28 (1940); *Senate Hearings, supra* note 36, at 711-58. Both the SEC and the representatives of the investment counsel industry who testified at hearings held by the SEC agreed that there existed an "investment counsel fringe which includes those incompetent and unethical individuals or organizations who represent themselves as bona fide investment counselors." H.R. DOC. NO. 477, 76th Cong., 2d Sess. 34 (1939).

38. *Senate Hearings, supra* note 36, at 48 (statement of David Schenker).

39. H.R. DOC. NO. 477, 76th Cong., 2d Sess. 29 (1939). In particular, the SEC study discussed the following potential areas of abuse:

- (a) The conflict of fiduciary obligations owed to corporation and client when an adviser is a corporate director of a corporation held in the portfolio of the adviser's client.
- (b) The affiliation of investment advisers with brokerage firms, because it may result in irreconcilable conflicts since the broker makes his commission on sales and thus has an interest in high turnover.
- (c) The trading by investment advisers for their own account in the same securities in which the client has an interest.
- (d) The use of percentage of profits as a means of compensating the investment adviser, because it may encourage the adviser to recommend a degree of risk that the investor himself would not knowingly undertake since the adviser has everything to gain if he is successful and little to lose if he is not.
- (e) The adviser maintaining custody of his client's funds and the potential risk of the adviser's use of these funds to avoid his own insolvency.
- (f) The assignment of control of the client's funds to another individual or firm without the knowledge or consent of the client. *Id.* at 29-30.

ied, it seems apparent that the original working assumption of Congress in passing the Advisers Act was that the adviser would render disinterested investment advice concerning securities to an advisee-firm in which the adviser was neither an investor nor a full-time, salaried employee-manager but in whose performance the adviser did have a potentially conflicting pecuniary interest requiring regulation.⁴⁰ This working assumption was expressly recognized by the Supreme Court in *SEC v. Capital Gains Research Bureau, Inc.*,⁴¹ when it noted that the Advisers Act "reflects . . . a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not *disinterested*."⁴² Furthermore, it seems evident from various legislative materials that Congress viewed investment advisers as separate, independent professionals who provide counsel to unrelated investors.⁴³

The Advisers Act was originally characterized by both the SEC⁴⁴ and Congress⁴⁵ as "a simple form of registration" intended merely to screen out persons considered inappropriate for the profession. However, industry representatives unanimously recognized from the outset that the proposed bill went far beyond simple registration requirements.⁴⁶ For example, Rudolf Berle,

40. Consider the specific abuses discussed in paragraphs (c) and (d) *id.* In paragraph (c), it was considered a potential abuse if the securities held by adviser and client were not mutually exclusive. The "heads I win, tails you lose" profit-sharing abuses described in paragraph (d), which eventually were addressed by § 205(1) of the Act, 15 U.S.C. § 80b-5(1) (1976), also reflect a concern that loses its force if the adviser and client have both committed funds to the investment.

41. 375 U.S. 180 (1963).

42. *Id.* at 191-92 (emphasis added).

43. See H.R. REP. NO. 2639, 76th Cong., 3d Sess. 28 (1940); S. REP. NO. 1775, 76th Cong., 3d Sess. 22 (1940) (general statements accompanying the reports of the finalized bill to both the House and Senate). See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963).

44. David Schenker, chief counsel of the SEC's Investment Trust and Investment Companies Study, testified that the bill attempts "to see if we could not get something which approximated a compulsory census. Fundamentally, that is the basic approach of Title II [Advisers Act]." *Senate Hearings*, *supra* note 36, at 48. Judge Robert E. Healy, then an SEC Commissioner, stated that "the real intent of Title II is to see to it that men with [criminal records] cannot go into the business of being investment advisers." *Senate Hearings*, *supra* note 36, at 757.

45. Senator Wagner, Chairman of the Senate Subcommittee that held hearings on the Advisers Act, stated that the Act required "a simple form of registration of some kind to the end that we do not put a man who is just out of jail in that work [investment adviser], or somebody who has been engaging in all kinds of practices and has been enjoined." *Senate Hearings*, *supra* note 36, at 746.

46. See *Senate Hearings*, *supra* note 36, at 711-58. Nearly all of the industry spokes-

General Counsel to the Investment Counsellors Association of America, criticized the section 202(a)(11) definition of investment adviser as being overly broad and so vague that one could not tell who was to be included within its scope.⁴⁷ Presumably, Congress adopted such an all-inclusive definition to allow it to be adapted to then unforeseen investment advisory contexts.⁴⁸

Reflecting the primary concern of Congress, the bulk of the Advisers Act focuses on the compulsory census of advisers. This is accomplished by the detailed registration and reporting requirements contained in sections 203 and 204. In light of the sparse legislative discussion of conflict of interest problems,⁴⁹ it is not surprising that relatively few provisions of the Advisers Act deal with these issues.⁵⁰ The informational and noninformational regulations⁵¹ itemized in sections 205 through 208 seem to be stop-gap measures addressed to the specific abuses of the "investment counsel fringe" uncovered in the SEC's study of investment advisers. The statutory regulations and authorization for agency rules are designed to preserve "the delicate fiduciary nature of an in-

men testifying at the congressional hearings represented major investment counsel firms, which for the most part acted almost exclusively as advisers to investment companies, insurance companies, or other large corporate investors. By the admission of the chief counsel of the Investment Trust and Investment Companies Study, the final draft of the Advisers Act was written by one of these industry spokesmen. *Id.* at 1124 (statement of David Schenker). Until amended in 1970, the Advisers Act exempted from registration any investment adviser whose only clients were investment companies and insurance companies. This exemption was added to the final bill adopted after the Senate hearings, presumably by the industry representative who wrote the final draft. Compare S. 3580, 76th Cong., 3d Sess. § 204(b) (1940) with the Investment Advisers Act of 1940, ch. 686, § 203(b)(2), 54 Stat. 847 (1940) (current version at 15 U.S.C. § 80b-3(b)(2) (1976)). This apparently little-known, and completely undiscussed, addition to the registration exemptions effected a significant change in the coverage of the Advisers Act and may explain the industry's about-face endorsement of the bill. In 1970, the investment company client exemption was deleted. Investment Company Amendment Act of 1970, Pub. L. No. 91-547, § 24(a), 84 Stat. 1413 (amending 15 U.S.C. § 80b-3(b) (1970)).

47. *Senate Hearings*, *supra* note 36, at 748.

48. The definition criticized by Mr. Berle was adopted virtually intact. Compare S. 3580, 76th Cong., 3d Sess. § 45(a)(16) with Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976).

49. See *Senate Hearings*, *supra* note 36, at 320.

50. See note 39 *supra*.

51. A "noninformational" securities regulation, as that term is used by Professor Ronald J. Coffey, is one which "prohibits a course of conduct even assuming, and notwithstanding, the exertion of maximum efforts to prevent information failure in connection with such conduct." R. Coffey, *Securities Regulation Policy & Analysis* 581a (1978) (unpublished multilith, Case Western Reserve University School of Law). This contrasts with a disclosure regulation which is primarily "informational." See Coffey, Book Review, 124 U. PA. L. REV. 268, 278-79 (1975).

vestment advisory relationship.”⁵² Perhaps because the legislative history is so sparse, the fabric of the adviser’s fiduciary duty has been much more substantially developed by the SEC⁵³ pursuant to its broad definitional and rulemaking powers under section 206. Development of the adviser’s fiduciary duty, however, has not altered the Advisers Act’s original view of the adviser as an independent professional, counseling or acting on behalf of a client in a context not addressed, or not adequately addressed, by traditional business association law. In other words, the Act directly contemplated an adviser rendering securities advice other than in the context of irrevocable discretionary management prerogatives invested in him as manager generally of all the affairs of a firm.

It should not be concluded, however, that general partners are not investment advisers within the meaning of the Advisers Act merely because the original congressional enactment failed to discuss the type of business relationship found in limited partnerships. The popular use of the limited partnership form for investment and tax shelter purposes is a relatively recent phenomenon, occurring for the most part after World War II. It may well be that Congress merely overlooked limited partnerships. In order to understand how the Advisers Act applies to general partners, it is necessary to explore the nature of the protections Congress sought to provide in adopting both the Advisers Act and its companion enactment, the Investment Company Act (the Company Act).⁵⁴ Specifically, this Note will examine the distinctive regulations developed by these two statutes for investment advisers on one hand and internal business managers on the other.

C. *Business Manager vs. Investment Adviser*

The drafters of the Advisers Act sought to provide protection for the securities investor in an adviser-client relationship. Although there was little indication of an intent by Congress to regulate business association law internal managers⁵⁵ by calling them investment advisers, the possibility of such regulation arises in all

52. 2 L. LOSS, *SECURITIES REGULATION* 1412 (2d ed. 1961).

53. The SEC’s development of the antifraud provisions in §§ 205 and 206 may be classified in three categories: conduct involving misrepresentation or nondisclosure, conduct not involving misrepresentation or nondisclosure that is nevertheless fraudulent or deceptive, and conduct involving adviser-client fee arrangements. See Note, *supra* note 17, at 325–30 & 326–30 nn.108–35.

54. 15 U.S.C. §§ 80a–1 to –52 (1976).

55. The term “business association law internal managers” is used here to describe those persons who are given discretionary management prerogatives by virtue of business

business firm contexts, including the corporate form. To the extent Congress chose to regulate internal managers, it most clearly did so in the Company Act.

The Company Act is, for the most part, a general corporate statute which regulates capital structure, management qualifications and functions, management transactions, participation of shareholders, financial accounting, and disclosure duties of companies that engage primarily in the business of investing and reinvesting in securities of other companies.⁵⁶ The Company Act, like the Advisers Act, performs a crude occupational licensing function by providing for the registration of officers, directors, partners, and investment advisers of investment trusts and companies.⁵⁷ Notably, however, the Company Act also provides for substantial regulation of investment advisers,⁵⁸ contrasting in coverage and specificity with the few conflict of interest prohibitions found expressly in the Advisers Act.⁵⁹

The Company Act specifically excludes from its definition of investment adviser any "bona fide officer, director, trustee, member of an advisory board, or employee of such [registered investment] company, as such"⁶⁰ The original Company Act bill,

association law and who are exercising these prerogatives on a full-time basis without any special compensation for advice as to securities held in the firm's portfolio.

56. See 1 L. LOSS, SECURITIES REGULATION 144-53 (2d ed. 1961 & Supp. 1969).

57. Company Act § 8(b)(4), 15 U.S.C. § 80a-8(b)(4) (1976); cf. *id.* § 9(a), 15 U.S.C. § 80a-9(a) (setting forth disqualifying characteristics of potential investment company personnel).

58. The Company Act significantly differs from the Advisers Act in its definition of investment adviser. See notes 60-63 *infra* and accompanying text.

59. Section 206(3) of the Advisers Act, 15 U.S.C. § 80b-6(3) (1976), see note 14 *supra*, addresses, from an informational point of view, certain potential adviser conflict of interest matters in the highly distilled form of securities purchases and sales. As previously noted, see notes 8 and 40 *supra*, § 205(1), 15 U.S.C. § 80b-5(1) (1976), and the proviso thereto also explicitly regulate adviser-advicee compensation arrangements—contractual relationships in a setting where conflict of interest is a factor. On the other hand, §§ 205(2) and (3), *id.* §§ 80b-5(2) to -5(3), merely personalize the contractual duty of the adviser to the advicee; §§ 206(1), (2), and (4), *id.* §§ 80b-6(1) to -6(2), -6(4), are general antideception prohibitions.

By contrast, §§ 15(a) and (c) of the Company Act, *id.* §§ 80a-15(a), -15(c), specifically regulate, in an expressly organizational setting, the threshold procedural conditions under which an advisory contract can come into being; § 36(b), *id.* § 80a-35(b), imposes a "fiduciary duty" upon the adviser enforceable by the SEC or the investment company shareholders; and § 17(i), *id.* 80a-17(i), prohibits waiver of contractual liability for high degrees of misconduct, beyond the prohibition against waiver of the statute's effect found in § 47, *id.* § 80a-46. For further instances in which the Company Act regulates potential conflict of interest matters, see §§ 10, 15, 17, 21, 25, *id.* §§ 80a-10, -15, -17, -21, -25.

60. Company Act § 2(a)(20), 15 U.S.C. § 80a-2(a)(20) (1976).

however, contained a definition of investment adviser⁶¹ identical to that used in section 202(a)(11) of the Advisers Act that makes no reference to investment company officers and directors. Nevertheless, the final draft of the bill that was passed by Congress specifically excluded officers, directors, and other management employees acting as such from investment adviser status under the Company Act,⁶² while retaining the original definition for the Advisers Act.⁶³ A general partner of an investment partnership is analogous to a director of a corporate investment company and, in fact, meets the statutory definition of director in the Company Act.⁶⁴

There are a number of possible interpretations of Congress' specific exclusion of officers, directors, and others acting as such from the definition of investment adviser in the Company Act and its failure to mention the regulation of internal managers, as such, in the Advisers Act. The separate treatment of advisers and managers perhaps indicates a reluctance by Congress to encroach upon management behavior to the extent that it takes place within the framework of the exercise of discretionary management prerogatives given by business association law, and clearly subject to its sanctions thereunder. This reluctance would be greatest where those prerogatives are exercised by those who devote most of their time to carrying out their business association law responsibilities. Note that whenever the Company Act wishes to encroach by way of regulation of internal managers acting as such, it does so under labels other than "investment adviser." Instead, the statute speaks to "officers, directors, or affiliates."⁶⁵

The unwillingness of Congress to provide that regulation applicable to investment advisers is applicable as well to internal managers acting as such on a full-time basis without special compensation for securities advice conceivably derives from the view that the beneficial owners of a particular enterprise have handed

61. S. 3580, 76th Cong., 3d Sess. § 45(a)(16) (1940).

62. Company Act § 2(a)(20), 15 U.S.C. § 80a-2(a)(20) (1976).

63. Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976).

64. Section 2(a)(12), *id.* § 80a-2(a)(12) (1976), defines "director" to include persons "performing similar functions" to that of a director, in the case of noncorporate entities. In considering registration of partnerships under the Company Act, the staff of the SEC has consistently regarded general partners of limited partnerships as directors within the meaning of the statutory definition. *E.g.*, Brian A. Pecker, SEC no-action letter (Oct. 3, 1974), *reprinted in* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,997; Carolina Palmetto Income Investors, SEC no-action letter (Feb. 22, 1974).

65. *E.g.*, Company Act § 10, 15 U.S.C. § 80a-10 (1976).

over discretionary management clearly and irrevocably to such internal managers.⁶⁶ Congress may have implicitly recognized that business association law constraints upon discretionary managers may be sufficient in those areas in which Congress chose to regulate only investment advisers and not internal managers. Business association law controls for discretionary managers may have been judged sufficient: (1) when they are clearly applicable, that is, when one is considering persons who clearly possess discretionary management prerogatives under state business association law and who, therefore, are clearly subject to duties arising from state law; (2) when the discretionary manager devotes most, if not all, of his time to carrying out his management function and furnishing particularized advisory services, thus assuring a certain level of diligence; and (3) when the discretionary manager is not separately paid, especially through a contingency arrangement, for the securities advisory aspect of his management function, a contractual arrangement which could create a conflict between his overall objectives as manager and his objectives as a securities adviser.

In circumstances where Congress chose to regulate discretionary managers even when the above conditions are met, it did so only in the Company Act, and then only under labels other than "investment adviser."

Other possible interpretations of Congress' intent may be drawn from the different definitions of investment adviser contained in the two acts, and specifically from the fact that the Advisers Act definition does not expressly exclude internal managers, as does the Company Act definition.⁶⁷ An *expressio unius est exclusio alterius* argument might lead to the conclusion that Congress, by not specifically excluding internal managers from the Advisers Act definition, intended to include them. This argument gains further force if one assumes that Congress intended to leave no "gaps" in the regulation of internal managers of investment companies. Such a gap might exist because the various Company Act regulations of internal managers apply only to managers of *registered* investment companies.⁶⁸ Because there are many ex-

66. If this is the rationale, then it is even more directly applicable in the limited partnership context than in the corporate situation since limited partners hand over management to general partners to a greater extent than shareholders. See Gabinet and Coffey, *The Implications of the Economic Concept of Income for Corporation-Shareholder Income Tax Systems*, 27 CASE W. RES. L. REV. 895, 901-03 n.29, 909 (1977).

67. Compare Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976) with Company Act § 2(a)(20), *id.* § 80a-2(a)(20) (1976).

68. *E.g.*, Company Act § 9(b), 15 U.S.C. § 80a-9(b) (1976) (stating that certain per-

emptions from registration as an investment company,⁶⁹ the internal managers of many investment companies would be outside the scope of the Company Act. This is of particular relevance here because the vast majority of limited partnerships that would otherwise often qualify as investment companies are not registered as investment companies because they tailor their structure to fall within one of the specific exemptions.⁷⁰ Thus, the Commission has argued that the Advisers Act steps in to fill the unwanted regulatory gap that exists for the internal managers of unregistered investment companies.⁷¹

This explanation of Congress' exclusion of internal managers from the definition of investment advisers in the Company Act does not seem compelling. On the most superficial level, it can be said that the Company Act, which regulates investment vehicles in clear coordination with those vehicles' enabling business association law, is more applicable to the limited partnership context than is the Advisers Act, which is essentially a rough attempt at occupational licensing. In terms of statutory construction, the specific should control the general,⁷² and it is clear that Congress specifically and precisely dealt with investment vehicles *and their internal managers* in the Company Act. It would be a great interpretive leap to suppose that internal managers of unregistered investment companies were intended to be covered by the Advisers Act because their employers, still regulated to the same extent by business association law, are exempted from Company Act regulation. Rather, it would seem that Congress, having excluded internal managers from adviser status in the Company Act, never considered it necessary to also exclude them from the Advisers Act, since it was only the Company Act that was meant to apply to internal managers. That is, since the Company Act, unlike the

sons are ineligible to serve as internal managers of *registered* investment companies); *id.* § 36, 15 U.S.C. § 80a-35 (1976) (authorizing civil actions by the Commission for breach of fiduciary duty by internal managers of *registered* investment companies).

69. Company Act §§ 3(b), 3(c), 6, 15 U.S.C. §§ 80a-3(b), -3(c), -6 (1976).

70. Limited partnerships can fall within the § 3(c)(1) exemption from registration as investment companies when they are beneficially owned by fewer than 100 persons and they do not make a public offering of their securities. 15 U.S.C. § 80a-3(c)(1) (1976). See note 29 *supra*.

71. Supplemental Brief of the Securities and Exchange Commission, Amicus Curiae at 14-16, *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977) [hereinafter cited as SEC's Supplemental Amicus Curiae Brief]. See also Supplemental Brief for Appellants at 41-52, *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977).

72. See 2A J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 51.05 (4th ed. C. Sands 1973).

Advisers Act, deals so comprehensively with the internal operations of the recipient of the advisory services, it was presumably only with respect to the Company Act, and not the Advisers Act, that Congress considered that the term "adviser" might be taken in all cases to include internal *managers*, unless Congress took the trouble, as it did, to provide that "adviser" does not include internal managers acting as such and that such managers will be addressed, when necessary, by other terms.

There is an additional basis for concluding that Congress did not intend that full-time internal managers of federally regulated or unregulated investment companies or any other firms that might have securities in their portfolios should be considered investment advisers. Lawyers, accountants, engineers, and teachers are excluded from adviser status in the Adviser Act when their "performance of such [advisory] services is solely incidental to the practice of [their] profession."⁷³ Brokers and dealers are excluded when their advisory services are "incidental" and when they "receive no special compensation therefor."⁷⁴ The bases for these two exclusions are that such individuals' advisory services are customarily incidental to their profession and that they usually receive no special compensation for such advice. A similar rationale also underlies the exclusion of most business association law internal managers from advisory status. These internal managers perform numerous managerial functions which, for the most part, are unrelated to securities advice.⁷⁵ In addition, their compensation package may be wholly undifferentiated between compensation for securities advice, if any, and that for their other managerial services. Congress may well have recognized that in most internal manager situations, it would be administratively impossible to determine which persons were being specially compensated for investment advice. In short, the very criteria which exclude lawyers, accountants, and brokers and dealers from investment adviser status may exclude most business association law internal managers even more convincingly.

There is one final theoretical observation which renders the section 202(a)(11) definition of investment adviser inapplicable to many business association law internal managers and particularly

73. Advisers Act § 202(a)(11)(B), 15 U.S.C. § 80b-2(a)(11)(B) (1976).

74. *Id.* § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C) (1976).

75. Advice is used here in its broadest sense to include both informational consultation as well as managerial discretion over securities accounts. *See Abrahamson v. Fleschner*, 568 F.2d 862, 870-71 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978).

general partners of limited partnerships. If the "entity" concept of firms is to be accepted, a particularly strong argument can be made that the limited partnership entity is separate and distinct from the limited partnership investors.⁷⁶ Hence, if the general partner is deemed to be advising anyone, it would be the "entity" and not the limited partners. But the general partner, as one fully in control of day-to-day management, "is" this separate partnership entity as far as decisionmaking is concerned. In this regard, then, his posture is comparable to that of the corporate officer and director who stand within the corporate entity with a role distinguishable from that of the shareholders. When the internal manager has complete and irrevocable managerial discretion with regard to securities in the business' portfolio, how can it conceptually be argued that the manager is advising "others" as the section 202(a)(11) definition requires?⁷⁷

This type of conceptual difficulty was raised and resolved soon after the adoption of the Advisers Act in *In the Matter of Augustus P. Loring*.⁷⁸ In discussing the application of the section 202(a)(11) definition to a legal trustee, the Commission⁷⁹ stated:

Applicant's services under these appointments are not limited to supervision of investments but include all other services ordinarily incident to the ownership and management of property. Likewise, when applicant acts with regard to real property whether under court appointment or under an indenture, *he acts as principal*. Title to the real property is in his name, and his duties include all services ordinarily incident to ownership and management of such property. Where the applicant acts under power of attorney, he has full control over the property in question and performs duties substantially similar to those performed as trustee. It is important to note that applicant's activities under the powers of attorney constitute only a minor part of his business and are, in effect, *incidental to* his business of acting as trustee.⁸⁰

A much later district court decision in *Selzer v. Bank of Bermuda Ltd.*⁸¹ followed this line of reasoning by holding that a "trustee

76. See *Gabinet & Coffey*, *supra* note 66, at 929-30.

77. 15 U.S.C. § 80b-2(a)(11) (1976); see Petitioners' Reply Brief at 8-9, *Fleschner v. Abrahamson*, 436 U.S. 913 (1978), *denying cert. to* 568 F.2d 862 (2d Cir. 1977).

78. 11 S.E.C. 885 (1942).

79. This decision was rendered by a Commission that included Robert E. Healy, the Commissioner who had overall supervision of the SEC's Study of Investment Trusts and Investment Companies and who testified at length before Congress during its discussions of the Company and Advisers Acts. See *Senate Hearings*, *supra* note 36, at 52.

80. 11 S.E.C. at 887 (footnotes omitted and emphasis added).

81. 385 F. Supp. 415 (S.D.N.Y. 1974).

does not advise the trust corpus, which then takes action pursuant to his advice; rather the trustee acts himself as principal.”⁸² Although the staff of the Commission currently seeks to limit the effect of these decisions to their specific factual circumstances,⁸³ the decisions remain as the only authority of precedential value on this precise issue.

The same conceptual problem that the Commission and court recognized with regard to trustees, that is, that when they act, they give advice (informational or managerial) to themselves and not to “others,” is applicable to business association law internal managers who have irrevocable, discretionary day-to-day control. The Commission staff has concurred with this analysis in a recent no-action letter in which a bona fide director of an investment company was deemed not to be an investment adviser for purposes of either the Company Act or the Advisers Act.⁸⁴ The staff stated that “such a director rendering investment advisory services in his capacity as director generally would not be . . . deemed to be engaged in the business of advising *others*.”⁸⁵ If a bona fide internal manager acts in the exercise of broad discretion that is absolutely irrevocable, it is difficult to see how he can be advising anyone but himself. That is, it is difficult to find an advisee separate and distinct from the adviser.⁸⁶

The conceptual similarity of these various business association law internal managers and others functioning in a relationship with discretion granted subject to existing legal control—including general partners of limited partnerships, trustees of trusts, administrators of estates and pension plans, and investment officers of corporate investors—demonstrates that any wholesale inclusion of this group within the scope of the Advisers Act definition of investment adviser would be untenable. It seems unreasonable to suggest that this group constitutes an unregulated gap that the Ad-

82. *Id.* at 420.

83. See SEC’s Supplemental Amicus Curiae Brief, *supra* note 71, at 9–13.

84. Cornelius A. Rose Associates, Inc., SEC no-action letter (June 2, 1978), *reprinted in* [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,639.

85. *Id.* (emphasis added).

86. One anomaly may be the situation in which a discretionary decisionmaker for an *individual* in a simple agency relationship, without the overlay of trust, partnership, or corporation law, would almost always be called an adviser, no matter how broad his management discretion. In the case of a person making decisions for an individual, however, it would be rare for the decisionmaking power, although broadly discretionary—granting the right not only to choose securities to buy, sell, or hold, but also to execute securities transactions—to be irrevocable in the strict sense, even where the individual client might be subject to a breach of contract action for damages if he exercised his power to revoke.

visers Act could conveniently close. Such a function of the Advisers Act was never contemplated during the legislative hearings. Furthermore, the unregulated gap is metaphorically closer to a chasm, and it seems inconceivable that such a broad scale landfill was intended to be accomplished by a flexible application of the rather simply conceived Advisers Act.

The exclusion of many business association law internal managers from investment adviser status does not seem to be the result of oversight. Rather, the exclusion seems to have been intentionally based upon elements of internality and externality with respect to the legal relationships established by existing business association law. These elements include the degree to which investment advice is merely "incidental" to other managerial functions, whether the manager is being specially compensated for his advisory services, and the degree to which the manager is advising only himself and not "others." For analytical purposes, these elements may be viewed as separate continua, against which one can measure the relationship of specific business managers to their enterprises. Although the present discussion focuses upon general partners of limited partnerships, this construct can measure the advisory characteristics of any business manager.

II. APPLICATION OF INTERNAL-EXTERNAL CRITERIA

The three criteria of externality may be applied to specific limited partnership contexts to determine the extent of the advisory characteristics possessed by an individual general partner on a continuum of possible configurations. These criteria and their respective theoretical extremes can be illustrated by the following continua indicating a "nonadviser" characteristic on the left and an "adviser" characteristic on the right.

A. Nature of the limited partnership's *underlying asset project* as defined by the degree to which its portfolio contains securities.

No securities in partnership asset portfolio (only security involved is the limited partnership interest itself).



Portfolio contains securities.

B. Nature of the *management function* of the general partner, that is, whether he handles, alone or with others, all the affairs of the limited partnership.

General partner is a full-time manager of a single limited partnership, giving tailored attention to all affairs, including securities advisory services, to the firm.



General partner performs minimal managerial functions for a number of partnerships he has actively "structured" and provides stereotyped (*i.e.*, not tailored) securities management.⁸⁷

C. Nature of the *compensation arrangement* between the general partner and the limited partnership.

General partner receives undifferentiated compensation for the aggregate of managerial services he performs.



General partner receives special, differentiated compensation for his advice regarding securities and that compensation varies with his performance.

In applying these continua, an initial determination must be made with respect to the nature of the underlying asset project. Unless there is involvement with securities, the Advisers Act will not apply since the statute is, after all, only a form of securities regulation. If there is an involvement with securities, the focus will shift to the degree of externality of the general partner's managerial function and form of compensation, as reflected on continua B and C. The basic premise of this analysis is that a purely internal manager of a limited partnership should not be considered an investment adviser within the meaning of the Advisers Act. The Commission has implicitly recognized this position.⁸⁸ On the other hand, a general partner may in some circumstances possess external characteristics sufficient to qualify him for inclusion within the coverage of the Advisers Act. The various continua, and current position of the Commission with respect to each, will be considered in turn.

A. *Nature of the Limited Partnership's Underlying Asset Project*

The significance of a limited partnership's involvement with securities in its asset project may be misperceived. Of course, there must be a threshold involvement with securities in order to trigger any federal securities regulation. It is the contention of this Note, however, that in the investment adviser context, no amount of securities involvement with the limited partnership's underlying asset project should, without more, result in classification of its

87. See notes 29-30 *supra* and accompanying text.

88. Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975).

general partner as an investment adviser. So long as the general partner is a bona fide internal business manager acting as such in a full-time capacity and without special compensation for securities advice, then the limited partnership's nature as a securities investment vehicle should be irrelevant. Nevertheless, the underlying asset project's involvement with securities is discussed here for two reasons. First, the SEC has, to date, looked to the underlying asset project's involvement with securities as one determinant of a general partner's Advisers Act status.⁸⁹ Second, although the degree of securities involvement is not dispositive of the general partner's classification as an adviser, there may be a purely descriptive effect in the sense that the firm's increased interest in securities may increase the likelihood that the general partner will not conduct himself as a bona fide internal manager and may demonstrate some advisory characteristics.

The position of the SEC is that under the federal securities laws an offering of limited partnership interests generally constitutes an offering of a profit-sharing agreement or an investment contract,⁹⁰ which is a "security" within the meaning of section 2(1) of the Securities Act of 1933.⁹¹ Often the interest in the limited partnership will be the only security with which the general partner will have to deal in connection with his management duties. When this is the case, as for example when the limited partnership "portfolio" contains "only . . . whole works of art,"⁹² it becomes less tenable that a general partner be considered engaged in the business of advising others with regard to securities. Even so, a prominent member of the Commission staff has privately expressed the view that the general partner's advice to prospective limited partners with respect to the advisability of investing in his limited partnership's interests is, of itself, sufficient to place the

89. See notes 95-106 *infra* and accompanying text.

90. SEC Securities Act Release No. 4877 (Aug. 8, 1967), *reprinted in* 1 FED. SEC. L. REP. (CCH) ¶ 1046.

91. 15 U.S.C. § 77b(1) (1976).

92. The Consartium Fund, SEC no-action letter (Sept. 3, 1975). It is important to note, however, that ownership of tangible assets may still be considered an investment in securities, such as when the discretion to buy and sell the partnership's assets is given to an external adviser who simultaneously manages these assets together with the assets of other persons or entities as part of a common enterprise. See Thomas Beard, SEC no-action letter (May 8, 1975), *reprinted in* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,141; CoinVest, SEC no-action letter (June 10, 1974), *reprinted in* [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,823. This is an important concept because the portfolios of many limited partnerships might not seem, at first glance, to contain securities, when in fact they do.

general partner within the Advisers Act definition.⁹³ However, neither the Commission nor this staff member⁹⁴ has ever officially taken this position.

The Commission's difficulty in arriving at a consistent position in this area is well illustrated by its public response to two inquiries regarding limited partnerships formed to invest in commodity future contracts.⁹⁵ The SEC has consistently held that commodities and commodity future contracts are not securities.⁹⁶ However, when first queried as to the adviser status of a general partner of a limited partnership formed solely for the purpose of commodities trading, the staff recommended registration under the Advisers Act.⁹⁷ Applying the criteria developed for external advisers to commodities investors, the staff concluded that registration would be necessary because the general partner would be giving advice to the limited partners with respect to securities in the sense that the limited partners would not be purchasing *direct ownership* of commodity future contracts and there would be an *investment in a common enterprise*.⁹⁸ With reasoning that did not entirely follow, the staff then concluded that "if the general partner solicited persons to invest in the limited partnership, he would appear to be rendering advice as to investing in securities (i.e.,

93. See Lybecker, *Advisers Act Developments*, 8 REV. SEC. REG. 927, 928 (1975).

94. See Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975) (letter written by Martin Lybecker, SEC staff attorney).

95. Compare Thomas Beard, SEC no-action letter (May 8, 1975), *reprinted in* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,141 with Michael Coleman & Lawrence Grenon, SEC no-action letter (July 28, 1976).

96. E.g., Robert Enright, SEC no-action letter (Feb. 2, 1974), *reprinted in* [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,671; Oklahoma Commodity Fund, SEC no-action letter (Feb. 12, 1971), *reprinted in* [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,058.

In the Robert Enright letter the staff said that external advisers to commodity investment firms who advise such firms with regard to commodities and commodities futures will not fall within the Advisers Act so long as

- 1) each client purchases direct ownership of commodity futures contracts upon his own decision and in reliance solely on the speculative hope that the market price of the underlying commodities will vary in his favor and there is no investment in a common enterprise with others;
- 2) clients are not advised concerning commodity *option* contracts; and
- 3) clients receive no advice concerning conventional securities, including advice as to the relative desirability of investing in commodities as compared to conventional securities.

(emphasis in original).

97. Thomas Beard, SEC no-action letter (May 8, 1975), *reprinted in* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,141.

98. *Id.*

interests in the limited partnership).⁹⁹ This overinclusive definition of advice with respect to securities, which would have included all general partners who form limited partnerships regardless of the underlying asset projects involved, was quickly withdrawn. The staff expressly reconsidered these views in a subsequent no-action request presenting a similar factual situation.¹⁰⁰ The staff concluded that a general partner of a limited partnership investing solely in commodity futures would not be required to register so long as he would not be selling interests in more than one limited partnership at any one time.¹⁰¹

Two assumptions are implicit in this reconsideration. First, the staff recognized that advice to prospective limited partners regarding the purchase of an interest in a limited partnership is, without more, insufficient to qualify the general partner as a person "engaged in the business of advising others" with respect to securities. According to this analysis, in order for the Advisers Act to apply, the general partner must be continuously involved in the formation and promotion of limited partnerships. In such a situation, it could plausibly be said that the general partner was in the business of advising prospective limited partners as to the desirability of investing in limited partnership securities. This distinction between continuous and incidental promotion of partnership interests apparently captures the current position of the staff.¹⁰²

This position is consistent with the internal-external analysis developed above. When the general partner is continuously selling partnership interests, he is advising *prospective* limited partners,¹⁰³ without regard to their ultimate status as *actual* limited partners, and is not acting as the internal manager of the partnership entity. This leads to the second assumption implicit in the reconsideration of the initial overinclusive criteria. In its initial consideration of the issue the SEC staff focused on the limited partner's lack of direct ownership of the commodity futures and

99. *Id.*

100. Michael Coleman & Lawrence Grenon, SEC no-action letter (July 28, 1976).

101. *Id.*

102. See Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975).

103. It may be argued that even in this situation the general partner is not acting as the prototypical investment adviser envisaged by the framers of the Advisers Act. Unlike the prototypical adviser whose function is to provide disinterested investment advice with respect to the relative desirability of a broad range of investment opportunities, the general partner would be primarily advocating only his own investment. In this regard, he is much more akin to an issuer than an investment adviser.

his investment in a common enterprise as being a "security" with regard to which the general partner was deemed to be giving advice.¹⁰⁴ In its reconsideration, the staff implicitly shifted its focus from indirect ownership by the limited partner to the direct ownership by the partnership entity. Thus, the reconsidered position of the SEC staff focuses not only on the regularity of the general partner's promotion of limited partnership interests but also on the venture's involvement in securities in its asset pool. This is significant since otherwise even a non-securities investment by the limited partnership could be viewed as a form of indirect ownership or an investment in a common enterprise (the partnership itself), giving rise to securities advice by the general partner. In light of the staff's consistent failure to characterize as investment advisers those general partners of limited partnerships not investing in securities, it seems clear that the Commission has chosen not to go this far.¹⁰⁵ However, the degree of scrutiny involved increases when the underlying asset project of the limited partnership involves securities. This often involves a threshold issue of what constitutes a security with such a determination resting upon the facts of each investment situation.¹⁰⁶

Despite the importance which the SEC places on the limited partnership's degree of securities involvement, the policies and intended coverage underlying the protections provided in the Advisers Act and Company Act seem to indicate that the focus of the inquiry should more properly be directed to an examination of the general partner's status as a bona fide business manager. The two primary components of this status will now be examined.

B. *Nature of the Management Function of the General Partner*

As discussed above,¹⁰⁷ a general partner engaged full time in the broad range of managerial functions of a single limited partnership is closely analogous to a corporate officer having irrevocable discretion and management obligations under business association law for the day-to-day affairs of the corporation. Unless the general partner exhibits some external characteristics not contemplated by business association law, it does not seem justifi-

104. Thomas Beard, SEC no-action letter (May 8, 1975), *reprinted in* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,141.

105. *See, e.g.*, Michael Coleman & Lawrence Grenon, SEC no-action letter (July 28, 1976); The Consartium Fund, SEC no-action letter (Sept. 3, 1975).

106. *See* Coffey, *supra* note 27.

107. *See* notes 76-77 *supra* and accompanying text.

able that he should be included within that class of persons intended to be specially regulated by the Advisers Act. In the context of the manager's entrepreneurial function, external characteristics suggesting adviser status can be said to exist when the general partner's involvement with securities advice is more than incidental to his function as a bona fide business association law internal manager. The best example of this occurs when the general partner of a non-securities-related partnership is continuously involved in the formation of other limited partnerships. In this situation his investment advice to prospective limited partners may be more than incidental to his internal manager functions. His activities will not be that of a full-time internal manager, constantly subject to a duty of diligence and loyalty imposed by business association law with respect to one firm. Rather, it might be more properly said that he is "engaged in the business" of advising others with respect to securities.

The staff essentially recognized this position in a no-action letter which concluded that adviser status was inapplicable to general partners of a limited partnership formed for the sole purpose of effecting a corporate takeover.¹⁰⁸ Although the staff felt the general partners' activities in soliciting limited partners did fall within the definition of an investment adviser, when their activities were considered as a whole the staff concluded that the general partners were not " 'in the business' of advising others; rather their advisory activities [could] be considered to be a minor proportion of their general activity as general partners"¹⁰⁹ In view of their involvement with the sale of the partnership interests, the staff "reserve[d] the right to change [its] position if, among other things, [the general partners] were continually forming such limited partnerships or if they were otherwise engaged in advisory activities."¹¹⁰

Once the importance of external activity is acknowledged, the question becomes how much external activity a general partner may undertake before his advisory activities are not "solely incidental" to his internal managerial function. The staff has implied that adviser status in the non-securities-related limited partnership context would not attach so long as the general partner would not be selling interests in more than one partnership at any one

108. Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975).

109. *Id.*

110. *Id.*

time.¹¹¹ This should probably not be interpreted as meaning that a general partner can avoid adviser status merely by making serial offerings of partnership interests. Rather, his advisory activity must meet the "solely incidental" standard.

In the situation in which the general partner is selling partnership interests on a recurring basis, it is important to consider, as a related matter, whether his activities expose him to registration as a "broker."¹¹² In determining whether a general partner is engaged in the business of a securities broker, the staff tends to look to the same tests it has developed for corporate officers, directors, and employees who sell the corporation's securities.¹¹³ Some of the criteria for this test indicate elements of externality which may cause a general partner to be deemed an adviser. Specifically, a general partner's selling activities would not seem "solely incidental" to his managerial function if: (1) his management duties are primarily limited to selling the partnership's interests; (2) his affiliation with the limited partnership essentially ends after all the interests have been sold; (3) his compensation is closely tied to the sale of the limited partnership interests. These marks of externality reflect settings where business association law constraints on internal managers—traditionally developed duties, standards of diligence, and protections against conflicts of interest—do not adequately protect investors. Thus, special federal regulation seems warranted.

More difficult questions arise as to the general partner's adviser status where the underlying portfolio of the limited partnership contains securities. In this context the general partner may be

111. See Michael Coleman & Lawrence Grenon, SEC no-action letter (July 28, 1976).

112. A "broker" is defined as "any person engaged in the business of effecting transactions in securities for the account of others . . ." Securities Exchange Act of 1934, § 3(a)(4), 15 U.S.C. § 78c(a)(4) (1976).

It should be noted that this situation also involves the general partner's crossing the Advisers Act's definitional threshold, marking him as one who regularly "engages in the business of advising others." Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976). For a discussion of the possible classification and consequences of classification of general partners as brokers, see Hacker & Rotunda, *supra* note 9, at 326-34.

113. Hacker & Rotunda, *supra* note 9, note six factors applied by the SEC staff, each potentially sufficient by itself to establish broker status:

(1) if [the officer, director or employee] was hired specifically to sell the issuer's securities; (2) if he performs no substantial duties for the issuer other than selling the issuer's securities; (3) if his employment with the issuer will terminate after completion of the offering of securities; (4) if he was previously employed as a securities salesman; (5) if his compensation is in the form of commissions or fees on the sale of securities; or (6) if he sells the securities of the issuer on a recurring basis.

Id. at 328.

involved with securities advice on two levels and hence, it may be more difficult to say that his advice is solely incidental to his managerial function. First, any general partner who participates in the formation of the limited partnership is involved with securities advice on one level, that of selling partnership interests. A second level of advice would exist when the general partner is customarily consulted or has decisionmaking responsibility with respect to the securities in the underlying portfolio of the partnership. This advice immediately raises the conceptual problem discussed above¹¹⁴ that the general partner is not advising "others," but rather is merely advising himself. Furthermore, the express intention of the Company Act to exclude this type of advice from the definition of investment adviser¹¹⁵ militates against a conclusion that this second level securities advice should, without more, result in adviser status for the general partner. Here, the general partner's managerial function may be analogous to that of the investment officer of the corporate investor, a category specifically excluded from adviser status in the Company Act.¹¹⁶ However, when the general partner's function ceases to be analogous to that of a bona fide officer of a specific corporate investor and appears to resemble an independent contractor more than an employee, it would seem that he could then appropriately be deemed an investment adviser. This could occur, for example, when the general partner was specially compensated solely on the basis of the limited partnership's securities transactions.

The staff currently takes a very broad position with respect to the inclusion of general partners as investment advisers in the securities-related limited partnership context,¹¹⁷ as evidenced by its treatment of hedge funds.¹¹⁸ In *Abrahamson v. Fleschner*, the Commission argued and the Second Circuit adopted¹¹⁹ the view that the general partners of a hedge fund type limited partnership render investment advice when they decide, on a discretionary ba-

114. See notes 76-86 *supra* and accompanying text.

115. Company Act § 2(a)(20), 15 U.S.C. § 80a-2(a)(20) (1976).

116. *Id.*

117. See, e.g., Brian A. Pecker, SEC no-action letter (Oct. 3, 1974), *reprinted in* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,997; Brief of the Securities and Exchange Commission, Amicus Curiae at 9-12, *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978).

118. SEC's Supplemental Amicus Curiae Brief, *supra* note 71, at 16-21. See Brian A. Pecker, SEC no-action letter (Oct. 3, 1974), *reprinted in* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,997.

119. 568 F.2d 862, 870-71 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978).

sis, how to invest the limited partners' contributions in a portfolio of securities. Only when the general partner's duties are restricted to administrative management and do not include investment discretion has the staff stated that adviser status would not attach in a securities-related limited partnership.¹²⁰ However, the *Abrahamson* court went so far as to say that monthly reports issued by general partners to limited partners were sufficient investment advice to consider the general partners "engage[d] in the business of advising others" with respect to investments."¹²¹ At the portfolio-management level of the general partner's securities activities, then, the Commission and at least one influential court have appeared to look solely at the limited partner's reliance on his manager's investment discretion, without reference to the degree of protection offered by state business association law.

It is the final contention of this Note that the Commission, in adopting such a broad view, has not allowed for an appropriate distinction between an external and a purely internal general partner performing advisory services. The overinclusive categorization of general partners as investment advisers in the securities-related limited partnership context is further demonstrated by the staff's treatment of the compensation for advisory services, an important index of externality.

C. Nature of the Compensation Arrangement Between the General Partner and the Limited Partnership

The Advisers Act states that an investment adviser is one who renders securities advice "for compensation."¹²² In the limited partnership context, the staff has taken the position that reimbursement for expenses incurred in the formation of the firm

120. See Corbyn Associates, Inc., SEC no-action letter (June 20, 1977), reprinted in [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,252. In this securities-related limited partnership, the general partners, who formed the limited partnership, were not required to register as advisers when they performed the following duties: arranging for the limited partnership's legal and accounting services; issuing quarterly and annual financial reports to the limited partners; transmitting tax information to the limited partners; maintaining checking and brokerage accounts; and paying the necessary expenses incurred by the limited partnership. Portfolio management was provided under contract by an incorporated investment adviser of which the general partners of the partnership were employees. See also, Gardner and Preston Moss, Inc., SEC no-action letter (Feb. 23, 1972), reprinted in [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,638.

121. 568 F.2d at 870. The court reasoned that the monthly reports were relied upon heavily by the limited partners in their decisions whether or not to withdraw their funds from the investment pool.

122. Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976).

would meet the compensation requirements of the Act.¹²³ The required compensation has also been found when the general partner receives some portion of the brokerage commissions generated by a limited partnership's securities transactions.¹²⁴ In the hedge fund context, if the general partner is paid a share of the profits in excess of that to which he would be entitled based on his capital contribution to the partnership, the excess is viewed as compensation for investment advisory services.¹²⁵

The nature of the general partner's compensation can help to determine whether or not he is a bona fide business association law internal manager, properly excluded from the coverage of the Advisers Act. In making this distinction, it is again useful to analogize to the broker-dealer exclusion from the Advisers Act's definition.¹²⁶ In determining whether a broker or dealer has received special compensation, the Commission's General Counsel has stated that "[t]he essential distinction to be borne in mind in considering borderline cases . . . is the distinction between compensation for advice itself and compensation for services of another character to which advice is merely incidental."¹²⁷ This same test seems applicable in the limited partnership context. The compensation aspect of internality/externality goes hand in hand with the managerial function component discussed above. When the general partner receives an undifferentiated form of compensation for the totality of management functions he performs, he does not appear to be within the intent of the Advisers Act's definition. However, when he is specifically compensated for rendering securities advice, and that compensation is differentiated from his compen-

123. *E.g.*, John Terwilliger, SEC no-action letter (June 27, 1977); Hydrocarbon Resources, Ltd., SEC no-action letter (Feb. 29, 1975); Mattco Equities, Inc., SEC no-action letter (Jan. 15, 1972), *reprinted in* [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,660.

124. John Terwilliger, SEC no-action letter (June 27, 1977).

125. Mastoff & Weiss, *Personal Views of SEC Staff Members*, in PRACTICING LAW INSTITUTE, INVESTMENT PARTNERSHIPS AND "OFFSHORE" INVESTMENT FUNDS 363-64 (1969).

Of course, a general partner would face a conundrum if required to register because § 205(1) of the Advisers Act, 15 U.S.C. § 80b-5(1) (1976), expressly prohibits any compensation to registered advisers in the form of a share in profits or capital appreciation. *See* notes 8-10 *supra* and accompanying text. *See also* Lybecker, *supra* note 93, at 930.

126. Advisers Act § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C) (1976). A broker or dealer is excluded from the definition of investment adviser when his "performance of such services is solely incidental to the conduct of his business as a broker or dealer and . . . [he] receives no special compensation therefore." *Id.*

127. SEC Investment Advisers Act Release No. 2 (Oct. 28, 1940), *reprinted in* 5 FED. SEC. L. REP. (CCH) ¶ 56,156 at 44,055-2.

sation for other managerial services or, more acutely, when he receives *no other* compensation because he performs no other managerial functions, then he would presumably fall within the Advisers Act's intended coverage.

The use of compensation arrangements as an index of externality can also be applied in the context of a non-securities-related limited partnership. It seems clear that the general partner of a single limited partnership, charged with total management responsibility, is not receiving a differentiated compensation for securities advice. Even if he is reimbursed for expenses incurred in forming the partnership, it may be said that his total compensation will be "for services of another character to which advice is merely incidental."¹²⁸ However, when the general partner is continuously forming limited partnerships, his compensation for the advice that is involved in the sale of limited partnership interests to prospective limited partners will not be "merely incidental" to his compensation for other managerial functions.

The same analysis can be applied in the securities-related limited partnership context. The initial inquiry is the characterization of the general partner's managerial function, that is, whether he is charged with the full range of management responsibilities or whether his activities are solely related to the securities advice entailed in portfolio management. Can he be characterized as a bona fide business association law internal manager? One principal characteristic to be considered in this determination is whether the general partner receives special compensation for his portfolio investment advice. This situation may be indicated by compensation that is closely tied to the performance of the partnership's portfolio or by commissions that derive from the limited partnership's securities transactions, especially when the general partner receives no compensation for his other management duties.

III. CONCLUSION

The definitional treatment of general partners as investment advisers by the Second Circuit in *Abrahamson* and by the SEC in its no-action letters does not discriminate adequately between bona fide business association law internal managers and those individuals who, while perhaps appearing to act as internal managers, actually demonstrate characteristics which bring them within the intended coverage of the Advisers Act. The Advisers

128. *Id.*

Act and the Company Act were companion enactments which were intended to have different, though somewhat contiguous, coverage. The Company Act's separately categorized treatment of directors, officers, and other business managers as compared with advisers is significant. It suggests that since directors are not advisers under the Company Act when acting as bona fide directors, so general partners, when acting in a similar capacity, should not be advisers either. This logic applies equally to the intended coverage of both acts.

The legislative history of the Company Act does indicate an intention by Congress to encroach upon management behavior to a limited extent, even to the extent that it takes place within the framework of discretionary management prerogatives given and controlled by business association law. However, whenever the Company Act wishes to encroach by way of regulation of internal managers acting *as such*, it does so by using labels other than "investment adviser" to name them. When putative internal managers are not in fact acting as such—that is, when they do not devote themselves fully to their management function or when they are specially compensated for their securities advice—then it seems less plausible that they should be excluded from Advisers Act coverage. In short, a director, acting as such, is not an adviser. Likewise, when a general partner acts in a comparable capacity, he is not an adviser. However, when these individuals cannot be accurately characterized as bona fide internal managers, they should be given investment adviser status and exposed to the coverage of the Advisers Act.

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